



**Submission by  
Free TV Australia Limited**

Statutory Review of Division 376  
in Relation to Certain Production Levels

The Treasury

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## **1 Executive Summary**

- Free TV strongly supports the Producer Offset as introduced by the *Tax Laws Amendment (2007 Measures No. 5) Act 2007*.
- A clear objective of the Producer Offset was to create a more viable and market focussed Australian production industry through increased production and additional employment. It also aimed to encourage private investment in the industry. We are confident that the Producer Offset is achieving these aims.
- There is no evidence that the introduction of the Producer Offset has, or indeed will, impact on the sources of production.
- Broadcasters make production and programming decisions based on new and creative concepts which appeal to audiences – irrespective of whether they are generated in-house or externally. This has not changed since the introduction of the Producer Offset.
- We see no benefit to audiences or the production industry as a whole from changing the existing arrangements that have delivered a lively mix of independent and in-house productions of a quality that has long been recognised both here and overseas.
- For the Producer Offset to achieve its stated aim of stimulating and supporting all forms of Australian production, it must continue to apply equally to all producers.
- There is also no evidence that the introduction of the Producer Offset has detrimentally affected negotiations between producers and broadcasters regarding licence fees.
- Free TV is aware of calls for further regulation as regards recoupment structures and terms of trade. Free TV is strongly opposed to regulatory intervention in these areas.
- Restrictive rules governing recoupment structures and commercial terms would be unwarranted, inequitable and would provide a strong disincentive against private investment, to the detriment of the Australian production industry.



## **2 Introduction**

Free TV Australia represents all of Australia's commercial free to air television broadcasters. Free TV welcomes the opportunity to provide a submission to the statutory review of Division 376 in relation to certain production levels.

Commercial free to air broadcasters have made and continue to make a significant contribution to the production industry. Figures from the Australian Communications and Media Authority show that in 2006/07 television broadcasters spent \$790 million on Australian programming, including \$96 million on Australian drama. The Australian Film Commission's National Production Survey for 2006-07 shows that, as in previous years, amongst the Australian film/TV industry the largest contribution to the combined TV drama slate (and the largest from any sector) came from the commercial free to air broadcasters.

Commercial free to air television broadcasters broadcast over 500 hours of first-run Australian drama each year and exceed the 55% transmission quota in the Australian Content Standard.

Free TV welcomed the introduction of the Producer Offset last year as an important and timely initiative to encourage increased production levels. We are aware of concerns that the introduction of the Producer Offset would encourage broadcasters to commission in-house productions, to the detriment of the independent production sector.

The past 12 months show that these concerns are unfounded. Commercial broadcasters have continued to base their decisions as to which programs to commission and produce on those substantive factors which stand to impact on the likely success of the program and their longstanding individual production models.

The stated aim of the Producer Offset is to stimulate and support Australian production. For this to be achieved there must continue to be a level playing field and no distinction between different production houses. Both independent and in-house productions make a significant contribution to the overall health of the production sector in this country.

Free TV strongly supports the continued application of the Producer Offset equally across all sources of production of Australian programming.

This submission focuses on the key questions raised by the Discussion Paper for the statutory review and also raises some additional points regarding the operation of the Producer Offset.



### 3 Sources of programming

As required by section 376-275 of the Income Tax Assessment Act 1997, the statutory review is primarily focused on the impact of the Producer Offset on sources of programming. As outlined below, concerns that the Producer Offset would detrimentally impact on levels of independent production are unfounded.

Whilst it is clear that the Producer Offset has not impacted on decisions regarding the source of programming, Free TV maintains its view that the source of programming is not relevant to the objectives of the Producer Offset.

#### 3.1 The introduction of the Producer Offset has not impacted decisions regarding the source of programming

The introduction of the Producer Offset has had no impact on the manner in which commercial free to air television broadcasters commission and produce drama, other than to make it more attractive generally to invest in drama production.

Prior to the introduction of the Producer Offset, the priority for commercial free to air television broadcasters was to deliver the highest quality and most popular programs irrespective of origin. This has not changed since the introduction of the Producer Offset.

As outlined in more detail below at section 3.2 of this submission, broadcasters would never choose a program produced in-house over one produced by an independent producer merely because of the availability of the Producer Offset.

The primary effect of the Producer Offset has been to make drama a more attractive genre by increasing the available budget. It has not influenced the source of programming selected by broadcasters, with the majority of Australian drama delivered by independent producers.

During 2007-2008, of the 16 first run Australian adult dramas broadcast by the commercial broadcasters,<sup>1</sup> only four were produced in-house (*Canal Road*, *All Saints*, *City Homicide*, *Packed to the Rafters*). In each case, these productions were developed and commissioned on their creative and programming merits and prior to the introduction of the Producer Offset. All children's dramas broadcast in the past 12 months have been externally produced.

There continues to be a healthy balance between independent and in-house productions. With in-house productions such as *City Homicide* and *Packed to the Rafters* sharing success during 2008 with externally produced dramas such as *Underbelly* and *Sea Patrol*, it is clear that audiences do not make viewing choices based on the origin of productions.

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<sup>1</sup> Packed to the Rafters, Underbelly, City Homicide, Sea Patrol 2, All Saints, Home and Away, McLeod's Daughters, Rush, The Strip, Neighbours, Canal Road, Out of the Blue, Kenny's World, The Informant (telemovie), Emerald Falls (telemovie), Mark Loves Sharon



Further commercial free to air broadcasters take different approaches to sourcing Australian drama. These approaches have been developed over a long period of time and reflect each Network's creative requirements, resources and commercial positioning. The funding provided by the Producer Offset is not a sufficient inducement to change approach, as this would mean a change in creative direction as well as significant upfront investment through the establishment or expansion of internal production capabilities. The introduction of the Producer Offset has not altered the reliance by some broadcasters on independent production, for example, all of Network Ten's adult and children's drama continues to be commissioned from independent producers.

### **3.2 Source of programming is not relevant to the objective of the Producer Offset**

Whilst Free TV welcomes the opportunity to comment on the operation of the Producer Offset, we maintain our view that the source of programming (which is the issue of primary concern to the Statutory Review) is not relevant to the objectives of the Producer Offset.

The stated objective of the Producer Offset is to support the Australian screen media industry and to improve the market responsiveness of the industry. It is intended that increased production will deliver increased diversity and choice to audiences and encourage stable and sustainable production companies.<sup>2</sup>

Clearly, the focus of Government support measures must remain on boosting overall production levels and delivering greater benefit to viewers. The source of programming is irrelevant to both of these important objectives.

There is, and has been for many years, a healthy balance between in-house and external drama productions for television. Independently produced adult programs such as *Sea Patrol*, *Neighbours*, *RUSH*, *McLeods Daughters*, *Joanne Lees Murder in the Outback*, *Underbelly* and in past years, *Secret Life of Us*, *Last Man Standing*, *Mary Bryant*, *Blue Heelers*, *Young Lions*, *Through My Eyes*, *The Alice*, *Tripping Over*, *Jessica*, *the Society Murders*, *The Strip* and *Scorched* are balanced by some in-house dramas such as *Packed to the Rafters*, *Canal Road*, *All Saints*, *Home and Away*, *Always Greener* and *City Homicide*.

The balance is driven by the fact that broadcasters make production and programming decisions based on new and creative concepts which appeal to audiences – irrespective of whether they are generated in-house or externally. The source of programming will not drive a broadcaster to reject a superior concept and risk the project being picked up by a competitor and potentially the loss of thousands of viewers.

If the best idea for a program comes from an independent production company, it belongs to that producer. A broadcaster cannot produce the program without the participation of the owner of the concept. If the concept

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<sup>2</sup> Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No. 5) Bill 2007, page 184

is considered the one that will deliver the maximum audience, that is the driver for the commissioning decision.

Put simply, the business model for commercial broadcasters is to deliver the highest quality and most popular programs irrespective of origin.

The origin of programming is also not relevant to viewers. The standard of Australian productions – whether externally produced or in-house – is of primary interest to viewers. If a production is not of a sufficient standard, viewers will not watch it. This is the case regardless of how a particular production is produced. Nothing about the eligibility for the Producer Offset can change this basic commercial reality. When broadcasters commission productions, they will have most regard to the likely success of that production. In any event, Division 376 sets minimum expenditure thresholds to ensure that only high quality productions are able to benefit from the Producer Offset.

As can be clearly seen from ratings figures, viewers do not differentiate between in-house and independently produced programs. Both in-house and independent programs regularly feature in the top rating programs on Australia television. Top rating dramas on commercial television in 2008, such as *Underbelly* and *Packed to the Rafters*, are a mix of in-house and external productions. These programs attract average audiences of up to 1.9 million people per episode.

The purpose of the Producer Offset is to encourage greater levels of Australian production. This will occur through the production of popular and sustainable Australian programming that meets audience needs and not the commercial considerations of a few individuals. Clearly, in-house productions are capable of meeting those audience needs as well as independently produced programs.

### **3.3 In-house production makes a significant contribution to the overall health of the production sector**

In the context of the current review, it is worth noting the significant contribution of in-house productions to the overall production sector.

In-house production departments provide many people with valuable training and an opportunity to increase their skills base. It allows aspiring producers and others to take risks, make mistakes and learn from a wider creative team without the fear of adverse personal financial consequences. Many of today's independent producers got their start working for broadcasters with strong in house production departments such as the Seven Network or the ABC.

The opportunity to move between run of show regular employment with a broadcaster and independent projects is a welcome one for many in the production industry. Many independent producers, directors, writers, cameramen etc take the opportunity to work on in-house productions while they go about securing their next independent project and move between the two sectors throughout their career.



Reliable and steady employment is also valuable to women or those with family responsibilities, who may wish to remain in the production industry but may also need the security of ongoing and regular employment.

Both in-house and external productions draw from the same pool of creative and technical talent and resources. By supporting the availability of a wider talent pool for all productions, in-house productions support the overall health of the production sector.

### **3.4 Independent producers are a very small part of the broader production community**

It is also worth noting that independent producers form only a very small part of the overall Australian production industry. Production teams are made up of large numbers of creative participants, including actors, directors, editors, set designers, writers, composers, cameramen, gaffers and so on.

None of these participants have any interest in or entitlement to any funding arrangement such as a tax offset. Only the producer, who sits at the top of the production pyramid, has any interest in funding arrangements.

For the wider production community, the success of the Producer Offset will be measured in terms of its impact on overall production levels and not in terms of any fluctuations in sources of programming. For most of the production team, it makes little difference whether they are engaged by an independent production company or a broadcaster. It is the joint efforts of the whole production team that will deliver sustainable and popular programming.

## **4 Other impacts of the Producer Offset**

Free TV notes that the Statutory Review seeks input regarding the impact of the Producer Offset on the negotiation of licence fees. These matters are discussed below. Free TV has also taken the opportunity to comment on other aspects of the Producer Offset since its introduction last year.

### **4.1 Licence fees**

In broadcasters' experience, the availability of the Offset has not impacted negotiations with producers as regards licence fees.

Free to air television licence fees have not declined since the introduction of the Producer Offset and, for a number of productions, licence fees have increased significantly.

With the Producer Offset capped at 20% of eligible television productions, television broadcasters continue to provide the majority of funding for projects. The Producer Offset is seen as important top-up funding, providing further options for producers along with pre-sales, distribution advances and other sources of investment.



Commercial television broadcasters contribute to a project over and above the free to air licence fees through:

- Distribution advances/guarantees: these are payments for the acquisition of distribution rights in a project (excluding the Australian free to air rights). The levels of any advances/guarantees paid by commercial broadcasters have been at or significantly above market levels. Distributions advances/guarantees are provided above and beyond any free to air licence fees and investments made by commercial broadcasters.
- Investment: Commercial television broadcasters often make contributions in addition to licence fees and distribution advances/guarantees. In doing so, broadcasters take on risk as an equity investor in a project.
- Production cashflow: Distribution advances/guarantees, additional investment and licence fee contributions from free to air television broadcasters are typically paid in advance during production, well ahead of delivery of a project and at no cost to independent producers. This is a major benefit for independent producers and comes at significant cost to commercial broadcasters, particularly in the current credit market conditions. Financiers providing Producer Offset cashflow to independent producers are charging significant establishment fees and interest and obtain significant security for such loans.
- Development cashflow: Commercial broadcasters contribute significant development funding for projects (in some cases, all development funding is provided by broadcasters). In many cases, these projects are never commissioned and such funds are lost to the broadcasters.

It is not unusual for commercial broadcasters to provide several or all of the above contributions and the introduction of the Producer Offset has not significantly affected broadcaster contributions.

Finally, when assessing the impact of the Producer Offset on production levels it is important to recognise that the Producer Offset has delivered many benefits to the independent production sector compared with the previous arrangements, which increase their attractiveness as a production partner.

Prior to the introduction of the Producer Offset, the main avenues for top-up investment for independent producers was funding from the Film Finance Commission and the Division 10B and 10BA tax concessions. The Producer Offset has removed commercial and administrative barriers in the previous system, for example, by extending eligibility for support to long-form television series.

#### **4.2 Other impacts**

Whilst not specifically raised by the Discussion Paper for the statutory review, Free TV would like to comment on a number of issues which have arisen since the introduction of the Producer Offset.

#### 4.2.1 *Commercial negotiations regarding recoupment structures*

The legislative framework for the Producer Offset sets out the conditions for the availability of the Producer Offset but does not set down any requirements or restrictions as regards the treatment of the Producer Offset in recoupment structures.

Free TV strongly supports this approach, whereby such matters are left for commercial discussions. This approach is consistent with normal business practice and with the Producer Offset's objectives of encouraging private investment and a more sustainable and commercially focused production industry.

In commercial negotiations since the introduction of the Producer Offset, a number of independent producers have suggested that the Producer Offset entitles them to an 'equity share' in a production. Commercial broadcasters support the view that independent producers should retain an 'equity share' in a production.

However, independent producers have also claimed that the introduction of the Producer Offset means they are entitled a priority corridor to access project revenues – ahead of other investors who have provided at-risk investments. Free TV is aware of calls for legislative change to mandate such recoupment structures.

If the objectives of the Producer Offset to create a more market-responsive industry are to be met, recoupment structures must not be artificially constrained through regulation or legislation in the manner suggested by independent producers.

Investors who are considering contributing to a project expect reasonable rates of return and will not be attracted to at-risk investments where independent producers are provided priority access to revenues. Indeed, the tendency for such recoupment structures to discourage private investment has already been observed by broadcasters.

Prescriptive and inequitable rules which give independent producers automatic revenue entitlements will discourage private investment and would therefore undermine the objectives of the Producer Offset.

Further, there are no grounds for additional regulation of these issues, with independent producers faring quite well in commercial negotiations, having obtained substantial concessions.

Since the introduction of the Producer Offset, independent producers have successfully negotiated with broadcasters to obtain:

- Ownership of a project to the value of the Producer Offset (and in some cases more than the value of the Producer Offset); and
- A share of project revenues to the value of the Producer Offset (and in some cases more than the value of the Producer

Offset) but only after private equity investors have secured recoupment. In some cases however, broadcasters have made significant concessions and have provided independent producers with access to recoupment before commercial broadcasters have recouped investment.

These are very substantial concessions, especially when it is considered that in such scenarios, independent producers are not making at-risk contributions and are paid significant production fees from within a project's budget. In addition, in most such cases, broadcasters are already providing much of the funding for a project and may already have brought the project to the relevant producer.

To introduce restrictive rules governing recoupment structures would be unwarranted, inequitable and would provide a strong disincentive against private investment, to the detriment of the Australian production industry.

#### 4.2.2 *Terms of Trade*

Free TV is aware of support within the independent production sector for regulated terms of trade for television productions. Free TV does not support such an approach.

Productions are not standard products or business operations and do not lend themselves to standard terms. Productions vary greatly in budget, production funding arrangements and production models.

There is also great variety within the independent production sector, ranging from very experienced producers to producers with no experience. Producers can operate in very large production houses with significant infrastructure, or may work as individuals. Some independent producers are able to bring funding to projects through distribution deals while others rely on commercial broadcasters to source all funding.

There is no evidence to suggest the current, open-market approach is deficient or is delivering unwanted outcomes. Terms of commercial arrangements are most appropriately dealt with between the commercial parties. A commercially-focused approach is also consistent with the underlying objectives of the Producer Offset.

Regulatory intervention in the determination of commercial terms would be inefficient and would be a significant discouragement to private investors.

#### 4.2.3 *Funding for cashflow of the Producer Offset*

Broadcasters have observed that the majority of independent producers are experiencing significant problems with sourcing production cashflow financing for the Producer Offset portion of a production budget.



When such financing can be sourced, it can be extremely expensive, adding significant financing costs to a production budget. These difficulties have recently been exacerbated by the impact of the financial crisis on the price of credit.

Free TV supports amendments to the Producer Offset to accelerate the payment of the Producer Offset. This may include giving producer a right to claim the Producer Offset as soon as a production is completed, rather than waiting for the payment to be processed through annual tax returns.